



A REPORT
TO THE
ARIZONA LEGISLATURE

Accounting Services Division

Compliance Review

Eloy Elementary School District No. 11

Year Ended June 30, 2003



STATE OF ARIZONA
OFFICE OF THE
**AUDITOR
GENERAL**

Debra K. Davenport
Auditor General

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DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

November 23, 2004

Governing Board
Eloy Elementary School District No. 11
1011 North Sunshine Boulevard
Eloy, AZ 85231-2178

Members of the Board:

We have reviewed the District's single audit reports and Uniform System of Financial Records (USFR) Compliance Questionnaire for the year ended June 30, 2003, to determine whether the District substantially complied with the USFR.

As a result of our review, we noted significant deficiencies in internal controls that indicate the District had not complied with the USFR. District management should implement the recommendations we have described in this report within 90 days after the date of this letter. We have communicated specific details for all deficiencies to management for correction.

During the 90-day period, the District may request a meeting to discuss these recommendations with my Office and the Arizona Department of Education by calling Magdalene Haggerty, Accounting Services Director, or Michael Stelpstra, Accounting Services Manager.

A member of my staff will call the Business Manager in several weeks to discuss the District's action to implement these recommendations. After the 90-day period, my staff will schedule an on-site review of the District's internal controls to determine whether the District is in substantial compliance with the USFR. Our review will cover the deficiencies we have communicated to management as well as any other internal control deficiencies we are aware of at the time of our review.

Sincerely,

Debra K. Davenport
Auditor General

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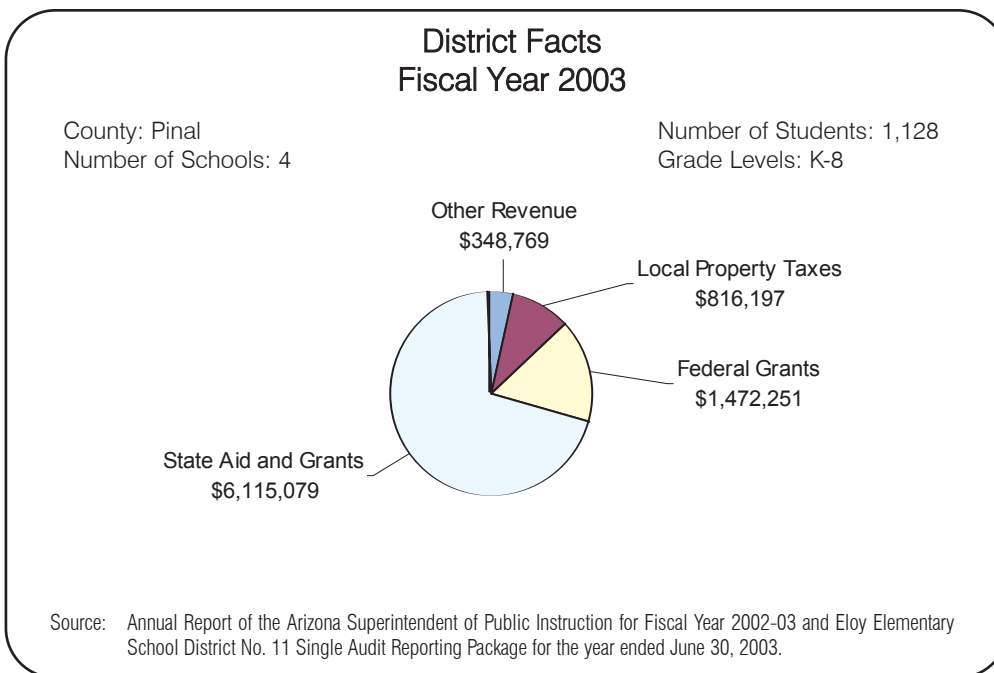
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INTRODUCTION

Eloy Elementary School District No. 11 is accountable to its students, their parents, and the local community for the quality of education provided. The District is also financially accountable to taxpayers for more than \$8.5 million it received in fiscal year 2002-03 to provide this education.

The District should use effective internal controls to demonstrate responsible stewardship for the tax dollars it receives. These controls are set forth in the *Uniform System of Financial Records* (USFR), a joint publication of the Office of the Auditor General and the Arizona Department of Education. The policies and procedures in the USFR incorporate finance-related state and federal laws and regulations and generally accepted accounting principles applicable to school districts. Districts are legally obligated to comply with USFR requirements, and doing so is good business practice.

As a result of our review of the District's single audit reports and USFR Compliance Questionnaire for the year ended June 30, 2003, we determined that the District had failed to comply with the USFR. We noted certain deficiencies in controls that the District's management should correct to ensure that it fulfills its responsibility to establish and maintain adequate financial stewardship and to comply with the USFR. Our recommendations are described on the following pages.



The District's controls over cash receipts and bank accounts should be strengthened

Poor cash controls left district and student monies susceptible to loss, theft, or misuse.

Because of the relatively high risk associated with cash transactions, the District should have effective internal controls to safeguard cash and ensure that it is promptly and accurately recorded and deposited, and that District bank accounts are used in accordance with Arizona Revised Statutes. However, the District did not separate cash-handling and recordkeeping responsibilities, as the same employee was often responsible for making deposits, signing checks, recording receipts and disbursements, and reconciling the District's bank accounts. In addition, the District did not deposit food service cash receipts in the Food Service Fund clearing bank account or remit monies deposited in the clearing account to the County Treasurer in a timely manner.

Also, the District did not always use its Maintenance and Operation (M&O) Fund revolving and Student Activities Fund bank accounts as provided by statute. Specifically, the M&O Fund revolving bank account was used for a payroll expenditure, and the Student Activities Fund bank account included monies labeled "General" that were used at the school principals' discretion.

Recommendations

To help strengthen controls over cash receipts and bank accounts, the District should establish and follow the policies and procedures listed below:

- Ensure that cash-handling and recordkeeping responsibilities are separated, and that an employee not responsible for handling cash or issuing checks reconciles the bank accounts. If the same employee must perform multiple functions, the bank reconciliations should be reviewed and approved by district management.
- Deposit food service cash receipts intact daily, when significant, or at least weekly.
- Remit monies deposited in the Food Service Fund clearing bank account to the County Treasurer weekly, or at least monthly.
- Use the M&O Fund revolving account only for activities that require immediate cash outlays such as postage, freight, express, fuel taxes, parcel post, travel, and other minor disbursements.
- Include only monies raised by student efforts in the Student Activities Fund bank account. Any other monies should be promptly removed from the account.

- Make disbursements from the Student Activities Fund bank account only as approved by student clubs and when clubs have sufficient cash available in their accounts.

The District should strengthen controls over payroll processing

Salaries, wages, and related payroll costs are a major portion of the District's total expenditures. Therefore, it is critical for the District to have strong payroll controls to ensure that employees are paid accurately. However, the District did not have adequate controls over payroll processing. Specifically, payroll processing responsibilities were not adequately separated. In addition, for hourly employees paid based on a prorated annual amount, the District did not review time sheets or ensure that these employees were paid for actual hours worked during the fiscal year. Also, the District did not require employees subject to the federal Fair Labor Standards Act (FLSA) to complete and submit timecards for performing extra duties; consequently, the District could not document that the stipend paid for the extra duties met the minimum wage and overtime requirements of the Act. Further, the District did not maintain a record of unclaimed wages.

The District's payroll procedures did not ensure compliance with the minimum wage and overtime requirements of the federal Fair Labor Standards Act or that hourly employees were paid accurately.

Recommendations

To help strengthen controls over payroll, the District should implement the following procedures:

- Separate responsibilities so that no one employee is responsible for preparing and authorizing payroll and distributing or retaining unclaimed payroll checks.
- Ensure that employees subject to the FLSA complete a time sheet each pay period that is signed by the employee, approved by the employee's supervisor, and retained to support the payroll for all duties that the employee performed. In addition, for hourly employees paid based on a prorated annual amount, the District should monitor the amounts paid to these employees to ensure that they are paid only for actual hours worked during the fiscal year.
- Ensure that wages paid to employees subject to the FLSA meet the minimum wage and overtime requirements of the Act.
- Maintain a record of unclaimed wages.

USFR page VI-H-1 describes the appropriate separation of duties for payroll processing.

The District should ensure the accuracy of its accounting records

The District's Governing Board depends on accurate information so it can fulfill its oversight responsibility and to report accurate information to the public and agencies from which it receives funding. To achieve this objective, management should ensure

The District did not ensure the propriety and accuracy of its accounting records by limiting access to the records to appropriate individuals.

that transactions are authorized and recorded correctly in the appropriate accounts. However, the District did not fully accomplish this objective as the District did not require journal entries to be reviewed and approved. Also, federal and state grant revenues were not always properly coded. In addition, the District did not restrict the ability to revise accounting records to appropriate individuals, as all departments in the administrative office had access to the general ledger.

Recommendations

To help ensure the accuracy of the District's accounting records, the District should ensure that journal entries are reviewed and approved by someone other than the preparer before they are recorded in the accounting records. Also, the District should classify and record all transactions in accordance with the USFR Chart of Accounts. In addition, the District should restrict access to its accounting records to appropriate personnel. Personnel should only have access to areas that are directly related to their department or function (e.g., the payroll department should not have access to capital assets records).

The District's controls over its capital assets should be strengthened

The District has invested a significant amount of money in its capital assets, which consist of land, buildings, and equipment. In order to protect its investment, effective stewardship requires the District to have an accurate list of these assets to ensure they are properly identified and accounted for. However, the District's capital assets list did not always include the information required by the USFR, was not separated by asset category (i.e., land and improvements, buildings and improvements, and equipment), and did not include assets acquired through on-behalf payments by the Arizona School Facilities Board (SFB). In addition, the District did not properly value a lease-purchased asset on the list. Further, the District had

The District did not maintain a complete and accurate record of its capital assets.

not performed a complete reconciliation of capital acquisitions to capital expenditures or reconcile its current year's capital assets list to the previous year's list.

Recommendations

The following procedures can help the District ensure that its capital assets list is accurate and complete:

- Include all required information for each item on the capital assets list and maintain the list by asset category.
- Include all capital assets acquired by the SFB for the District on the capital assets list.
- Record lease purchases on the capital assets list at the lesser of the fair market value at the inception of the lease or the present value of the net minimum lease payments (usually the principal amount) at the beginning of the lease term.
- Reconcile items added to the capital assets list during the fiscal year to capital expenditures for all funds that acquired capital assets during the year.
- Reconcile the prior year's capital assets list to the current year's list, and make all necessary corrections.

USFR pages VI-E-2 and 3 describe information that should appear on the capital assets list.

The forms on USFR pages VI-E-13 and 14 may be used to document the reconciliation of capital assets additions to capital expenditures and the current year's capital assets list to the previous year's list.

The District's supplies inventory lists should be accurate and complete

The District used financial resources to purchase supply items, such as educational, office, custodial and cleaning, food, and repair and maintenance supplies. Effective internal control policies and procedures over supplies inventory helps to prevent theft, overstocking, spoilage, and obsolescence, and provide for accurate financial reporting. However, the District did not adequately control its supplies inventory. Specifically, the District's food service and general supplies inventory lists did not always include the information required by the USFR, and some items were incorrectly recorded at catalog prices instead of the price actually paid. In addition, the District did not always maintain documentation to support supplies purchases and did not establish procedures to periodically review its supplies inventory to identify obsolete items.

Recommendations

The following procedures can help the District maintain effective internal control over its supplies inventory:

- Include item and unit descriptions, purchase document numbers, quantities, unit costs, extended costs, page totals, and a grand total on the supplies inventory lists.
- Value inventory at actual cost, which includes invoice price plus ancillary costs such as freight, sales taxes, and any other handling costs.
- Retain cost documentation for all items recorded on its supplies inventory lists.
- Establish procedures to identify obsolete items, which includes optimal minimum and maximum stock levels. Optimal stock levels of inventory help minimize inventory carrying costs and the risk of inventory obsolescence.